Supreme Court, U.S.
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No. 92-460

In the Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES L. HONEY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

KENNETH W. STARR
Solicitor General
JAMES A. BRUTON
Acting Assistant Attorney General
RICHARD FARBER
BRIDGET M. ROWAN
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 514-2217

13pp

QUESTIONS PRESENTED

1. Whether a corporate official charged with the responsibility under Section 6672 of the Internal Revenue Code of collecting, accounting for and paying over to the United States income and social security taxes withheld from the wages of the corporation's employees is personally liable for the corporation's unpaid employment taxes when, after becoming aware of the corporation's employment tax delinquency, he continues to disburse funds from the company's checking account to satisfy the claims of other creditors.

2. Whether the court of appeals correctly directed the district court to enter judgment for the United States.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	6
Conclusion	10

TABLE OF AUTHORITIES

Cases:

Davis v. *United States*, 961 F.2d 867 (9th Cir. 1992)	7, 8
Garsky v. *United States*, 600 F.2d 86 (7th Cir. 1979)	7, 8
Kizzier v. *United States*, 598 F.2d 1128 (8th Cir. 1979)	7, 8
Mazo v. *United States*, 591 F.2d 1151 (5th Cir.), cert. denied, 444 U.S. 842 (1979)	7, 8
Purdy Co. v. *United States*, 814 F.2d 1183 (7th Cir. 1987)	7
Slodov v. *United States*, 436 U.S. 238 (1978)	5, 6, 7, 8
Turnbull v. *United States*, 929 F.2d 173 (5th Cir. 1991)	7
United States v. *Vespe*, 868 F.2d 1328 (3d Cir. 1989)	7
Wood v. *United States*, 808 F.2d 411 (5th Cir. 1987)	7

Statutes and rule:

Internal Revenue Code (26 U.S.C.):	
§ 3102 (1988 & Supp. II 1990)	6
§ 3402	6
§ 6672 (1988 & Supp. II 1990)	3
§ 6672(a) (1988 & Supp. II 1990)	3, 6
§ 7501	6
Fed. R. Civ. P. 50	6, 10

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 963 F.2d 1083. The opinion of the district court (Pet. App. 21a-31a) is reported at 760 F. Supp. 754.

JURISDICTION

The judgment of the court of appeals was entered on May 7, 1992. The court of appeals denied the petition for rehearing and suggestion for rehearing en banc on June 11, 1992 (Pet. App. 33a). The petition for a writ of certiorari was filed on September 9, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner and his associates Charles White and F. Peter Lee incorporated Phoenix Housing Systems, Inc. (Phoenix) in November 1984. Petitioner performed legal and financial work for the corporation, was a stockholder and member of the board of directors, and served as the corporate vice-president, secretary and treasurer (Pet. App. 2a-3a; Pet. 2-3).

Phoenix conducted business operations only during the last three quarters of 1985. Throughout that period, Phoenix failed to pay over any of the federal income and social security taxes that had been withheld from the wages of its employees (Pet. App. 2a-3a). At the end of October 1985, petitioner became aware that these withheld employment taxes had not been remitted to the Internal Revenue Service as required by law. Petitioner nonetheless allowed the corporation to continue disbursing funds to employees, suppliers, and other general creditors in an effort to keep Phoenix operating while he sought an investor to purchase the company. He made no payments towards either current or past due employment taxes. In late December 1985, two of Phoenix's lenders seized the corporate assets and thereby terminated corporate operations (*id.* at 3a).

During the period from November 1, 1985, until the demise of the corporation at the end of December 1985, Phoenix disbursed in excess of $114,000 to its general creditors. More than half of this amount was expended on corporate payroll. When the corporation ceased conducting business, its unpaid employment tax liability totaled $112,375.49. On June 20, 1988, the Internal Revenue Service assessed petitioner and several other individuals for the amount of withholding taxes due under Section

6672 of the Internal Revenue Code, 26 U.S.C. 6672.* Petitioner paid a portion of the assessed taxes and filed a claim for refund, which was denied (Pet. App. 3a-4a).

2. Petitioner then brought a tax refund action in federal district court (Pet. App. 3a-4a). The case was tried to a jury, which determined that, throughout the entire period of the company's existence, petitioner was a person charged with the responsibility under Section 6672 of collecting and paying over to the United States the employment taxes withheld from Phoenix's employees. The jury further determined, however, that petitioner became willful in his failure to pay over the corporation's employment taxes only on October 31, 1985, when he first became aware that these taxes were not being paid.

The jury did not make a determination of the *amount* of petitioner's liability, for that issue had been reserved by the parties for the district court. In determining the amount of the liability under Section 6672, the district court sought to determine whether, and to what extent, the corporation had funds available to satisfy the delinquent taxes after October 31, 1985, when petitioner became aware of the delinquency (Pet. App. 22a).

The government contended that Phoenix possessed unencumbered funds after that date that were sufficient

* 26 U.S.C. 6672(a) (1988 & Supp. II 1990) provides, in relevant part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. * * *

to satisfy the entire amount of the delinquent payroll taxes, but that petitioner had instead used those funds to pay other creditors of the corporation. Phoenix's bank statements for the months of November and December 1985 showed a positive opening balance, deposits of $101,759.51, and disbursements to other creditors of $114,179.23, more than half of which were used to pay employee wages (Pet. App. 3a, 26a).

The district court concluded, however, that these facts did not establish that Phoenix had any unencumbered funds after October 31, 1985. In reaching this conclusion, the court stated (Pet. App. 29a):

> [A bank officer] testified that for all days in October, November and December of 1985, the checks issued by Phoenix * * * that were presented to the bank for payment, were "force paid." This term means that there were no funds available in Phoenix['s] * * * bank account to pay the checks as they were presented. Instead, the checks were held, deposits were made to cover those checks, and the amounts of the checks were then cleared. Thus, the balance of the withdrawals and deposits made on any given day had little or no bearing on the extent of unencumbered funds available to the company.

For this reason, the court concluded that petitioner was not liable for any of the delinquent taxes owed for the period prior to October 31, 1985 (Pet. App. 4a, 30a). The court held, however, that petitioner was liable for the $13,161.10 in taxes that were withheld from employees' wages during the months of November and December 1985 and not paid over to the United States.

3. The court of appeals reversed the judgment of the district court to the extent that it exonerated petitioner

for the withheld taxes owed for the period prior to October 31, 1985 (Pet. App. 1a-20a). The court held that the bank records established as a matter of law that Phoenix had sufficient unencumbered funds after October 31, 1985, to satisfy the tax obligations that had accrued prior to that date (*id.* at 6a). The court rejected petitioner's claim that all of the funds deposited into Phoenix's accounts in November and December 1985 were subject to other creditors' secured claims. The court pointed out that petitioner failed to present evidence establishing that these funds were subject to any security interest and that, even if a security interest existed, it had not been enforced and the funds had in fact been used to pay employees, suppliers, and other unsecured, general creditors (*id.* at 13a-16a). When petitioner became aware of the unpaid employment taxes, it was incumbent upon him to apply all available funds that came into the corporation's possession to the corporation's delinquent employment liabilities and, in failing to do so, he became personally liable for such taxes under Section 6672 (Pet. App. 10a).

The court of appeals rejected petitioner's contention that this Court's decision in *Slodov* v. *United States*, 436 U.S. 238 (1978), supports the proposition that a person responsible for paying withholding taxes has no obligation to pay such taxes with funds that come into the possession of the corporation *after* he becomes aware of the tax delinquencies. The court noted that *Slodov* concerned individuals who were *not* responsible for the payment of employment taxes during the period the delinquent taxes accrued. The court concluded that *Slodov* is not applicable to individuals, such as petitioner, who *were* responsible for employment taxes during the period the taxes accrued (Pet. App. 7a-10a).

The court of appeals also rejected petitioner's assertion that, under Rule 50 of the Federal Rules of Civil Procedure, judgment could not be entered for the United States because the United States had not moved for judgment notwithstanding the verdict at the conclusion of the jury trial (Pet. App. 19a). The court pointed out that the appeal had not been taken from the jury's findings. Instead, the appeal was from the district court's ruling on the *amount* of petitioner's liability. The court therefore concluded that Rule 50 did not preclude the award of judgment to the United States on appeal.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Employers are required to withhold federal income taxes and social security taxes from the wages of their employees. 26 U.S.C. 3102 (1988 & Supp. II 1990), 3402. The taxes that are withheld constitute a fund that the employer holds in trust for the United States. 26 U.S.C. 7501. Under Section 6672 of the Internal Revenue Code, any person who is required to collect, account for, or pay over these trust fund taxes, who willfully fails to do so, becomes liable to the United States for the amount of the unpaid taxes. 26 U.S.C. 6672(a) (1988 & Supp. II 1990). See *Slodov* v. *United States*, 436 U.S. at 244-245.

Petitioner asserts (Pet. 13-19) that, under Section 6672, a person who was under a duty at all pertinent times to collect and pay over employment taxes, but who did not become aware until a later time that taxes for earlier quarters had not been paid by his employer, is not required to apply available funds that come into his em-

ployer's possession thereafter to the payment of the withheld taxes. As petitioner concedes (Pet. 14 n.12, 17-19), however, every court of appeals that has considered this question, including the court in this case, has disagreed with petitioner's contention. See Pet. App. 5a-19a; *Davis* v. *United States*, 961 F.2d 867, 871-878 (9th Cir. 1992); *United States* v. *Vespe*, 868 F.2d 1328, 1334-1335 (3d Cir. 1989); *Kizzier* v. *United States*, 598 F.2d 1128, 1134 (8th Cir. 1979); *Garsky* v. *United States*, 600 F.2d 86, 90-91 (7th Cir. 1979); *Mazo* v. *United States*, 591 F.2d 1151, 1156-1157 (5th Cir.), cert. denied, 444 U.S. 842 (1979). See also *Turnbull* v. *United States*, 929 F.2d 173 (5th Cir. 1991); *Purdy Co.* v. *United States*, 814 F.2d 1183, 1188 (7th Cir. 1987); *Wood* v. *United States*, 808 F.2d 411 (5th Cir. 1987). As the Fifth Circuit stated in *Mazo* v. *United States*, 591 F.2d at 1157:

> In the case of individuals who are responsible persons both before and after withholding tax liability accrues * * * there is a duty to use unencumbered funds acquired after the withholding obligation becomes payable to satisfy that obligation; failure to do so when there is knowledge of the liability * * * constitutes willfulness.

2. There is no merit to petitioner's contention (Pet. 16-24) that these consistent decisions of the courts of appeals conflict with this Court's decision in *Slodov* v. *United States*, *supra*. In *Slodov*, the Court addressed the situation of an individual who becomes responsible for a corporation's withholding taxes *after* prior management (i) has used the funds represented by those taxes to pay other creditors and (ii) has left the corporation with no unencumbered funds with which to pay the taxes owed the United States. In these circumstances,

the Court held that the newly responsible individual is obligated to use funds that subsequently come into the corporation's possession to satisfy the prior tax delinquency only when the after-acquired funds are directly traceable to the dissipated trust fund taxes. 436 U.S. at 238.

Unlike the situation in *Slodov*, petitioner was at all times responsible for collecting and paying over Phoenix's trust fund taxes. He was therefore under a continuing duty to apply all unencumbered funds received by the corporation to satisfy the withholding tax obligations. His failure to do so constituted a willful failure to carry out his duties to the United States, thereby rendering him liable for the unpaid taxes under Section 6672. Nothing in *Slodov* supports petitioner's claim that an individual who *is* a responsible person when the withholding taxes accrued has no obligation to use funds acquired by the corporation afterwards to satisfy the unpaid taxes. As the Seventh Circuit stated in *Garsky* v. *United States*, 600 F.2d at 91:

> *Slodov* does not relieve a "responsible person" of the responsibility to reduce accrued withholding tax liability with funds acquired after the funds actually withheld have been dissipated so long as the person responsible has been so throughout the period the withholding tax liability accrued and thereafter. * * *

Accord *Kizzier* v. *United States*, 598 F.2d at 1130; *Mazo* v. *United States*, 591 F.2d at 1154; *Davis* v. *United States*, 961 F.2d at 876-878.

3. Petitioner errs in asserting (Pet. 24-27) that the funds that came into Phoenix's possession after October 31, 1985, were encumbered by claims of other creditors. The corporation's bank records establish that during the

months of November and December 1985 Phoenix made payments from its checking account to unsecured, general creditors, employees, and suppliers, totaling approximately $114,000. This amount exceeded the amount of unpaid withholding taxes (Pet. App. 3a). While these funds were available to pay the taxes due the United States, the corporation instead used those funds to pay the claims of other creditors (*ibid.*).

Petitioner asserts (Pet. 26) that the funds disbursed from the corporation's checking account during November and December were encumbered by a security interest possessed by the Merchants & Planters Bank & Trust Company (Merchants). While the record shows that Merchants obtained a security interest in Phoenix's inventory and the proceeds from sales of such inventory, there was no evidence that any of the funds deposited into Phoenix's checking account in fact represented proceeds from the sale of inventory (Pet. App. 13a-14a). As the court of appeals concluded (*ibid.*), the factual premise for petitioner's argument is therefore not established in the record.

Even if it were assumed that *some* of the funds deposited into the corporation's checking account were from the sale of inventory, none of those funds were encumbered by the bank's claim in any event. Paragraph 6 of the security agreement between Merchants and Phoenix provides that, upon Merchants' demand, Phoenix would be required to deposit the proceeds from inventory sales into a special bank account controlled by Merchants. But there is no evidence that Merchants ever invoked this provision (Pet. App. 15a). On the contrary, the record reflects that such restrictions were not imposed on Phoenix (*id.* at 15a-16a), for Phoenix did not use any of the funds deposited in its checking ac-

count during November and December 1985 to repay its obligations to Merchants. Instead, the funds were used to pay employee wages and the claims of other general, unsecured creditors and were not encumbered by the bank's potential security interest (*id.* at 3a).

4. The court of appeals also correctly rejected petitioner's contention that, under Rule 50 of the Federal Rules of Civil Procedure, the fact that the United States did not move for judgment notwithstanding the verdict precluded the award of any relief to the United States other than a new trial. As the court of appeals pointed out (Pet. App. 19a), the United States did not challenge the jury's verdict on appeal. The question on appeal instead concerned the calculation made by the district court concerning the amount of petitioner's liability. Rule 50 therefore has no application to this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

JAMES A. BRUTON
Acting Assistant Attorney General

RICHARD FARBER
BRIDGET M. ROWAN
Attorneys

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